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08MBAFM426/IB466/BF476

Fourth Semester MBA Degree Examination, June/July 2011
International Financial Management

Time: 3 hrs. Max. Marks:100

Note: 1. ***Answer any FOUR full questions from Q.No.1 to Q.No. 7.***
2. ***Question No. 8 is compulsory.***

Important Note : 1. On completing your answers, compulsorily draw diagonal cross lines on the remaining blank pages.
2. Any revealing of identification, appeal to evaluator and /or equations written eg, 42+8 = 50, will be treated as malpractice.

1 a. Distinguish between the spot market and the forward market. **(03 Marks)**
b. How does disequilibrium in the balance of payment arise? What are the measures for correcting this disequilibrium? **(07 Marks)**
c. A series of transactions between the Unites States and the rest of the world are given below :
i) An American company exports goods to a British company for \$ 2,000. The British company signs a bill of exchange for its imports.
ii) An Italian American ships \$ 3,000 worth of goods to his relatives in Italy.
iii) An American company imports \$ 500 worth of goods from Canada. The American company pays for the merchandise with a loan in Canadian currency.
iv) An American citizen goes on vacation to Mexico. He spends \$ 5000 before he returns to the US.
v) An American auto company decides to build on assembly plant in Hongkong. The American auto company ships \$ 4000 worth of material for this purpose to Hongkong.
vi) The American auto company finds it necessary to increase its investment by \$ 2,500 for the completion of the plant. It sells \$ 2,500 worth of its bonds to the citizens of Hongkong.
vii) An American citizen buys Korean Government bonds for \$ 3,000 in cash.
viii) A South African gold producer sells \$ 1,200 worth of gold to the Federal Reserve System of the United States.

With the help of the above transactions i) Record each transaction as debit or credit
ii) Prepare the Balance of payment for the United States. **(10 Marks)**

2 a. A French trader imports goods from London. The following market rates prevail :
€ / \$ = 1.18 / 1.19 ; £ / \$ = 0.69 / 0.70. Find the € / £ exchange rate. **(03 Marks)**
b. Discuss the factors influencing exchange rate movements. **(07 Marks)**
c. Spot rate of Mexican Peso is US \$ 0.100 . 180 day forward rate of Mexican Peso is US \$ 0.098 . 180 day Mexican interest rate = 6% ; 180 day US interest rate = 9%. Given this information, is covered interest arbitrage possible? **(10 Marks)**

3 a. From the following information, calculate the possibilities of arbitrage gain :
USD / AUD = \$ 0.554 ; JPY / USD = Yen 120 ; JPY / AUD = Yen 65. **(03 Marks)**
b. What is country risk? Explain the techniques to assess country risk. **(07 Marks)**
c. An Indian exporter has an ongoing order from USA for 2,000 pieces per month at a price of \$ 100. To execute the order the exporter has to import ¥ 6000 worth of material per piece. Labour costs are Rs 350 per piece while other variable overheads add up to Rs 700 per piece. The exchange rates are currently Rs 46.47/\$ and ¥ 108.12/\$. Assuming that the order will be executed after three months and payment is obtained immediately on shipment of goods, calculate the loss/gain due to transaction exposure if the exchange rates change to Rs 46.63 and ¥ 107.51. **(10 Marks)**

4 a. The current exchange rate is ¥ 122 / \$. If inflation in Japan is 2% and that in USA 3%, calculate the expected exchange rate after one year. **(03 Marks)**
b. Elucidate the Bretton woods system of foreign exchange. **(07 Marks)**
c. Write short notes on : i) Global bonds ii) SWIFT iii) Nostro and Vostro a/c iv) J – curve effect. **(10 Marks)**

5 a. What is crawling peg exchange rate regime? **(03 Marks)**
b. Who are the major participants in foreign exchange market? **(07 Marks)**
c. IAC Inc. is considering a new plant in Netherlands which will cost 26 million euros. Incremental cash flows are expected to be 3 million euros per year for the first three years, 4 million euros the next three, 5 million euros in year 7 through 9 and 6 million euros in years 10 through 19 after which the project will terminate with no residual value. The present exchange rate is € 0.69/\$. The required rate of return on repatriated dollars is 16%. Calculate the NPV of the project. **(10 Marks)**

6 a. What is a currency swap? **(03 Marks)**
b. Briefly explain the motives for FDI. **(07 Marks)**
c. An Indian exporting firm Kiran and Co., would like to cover itself against a likely depreciation of pound sterling. The following data is given
Receivables of Kiran and Co., £ 5,00,000 ; Spot rate : Rs 72.05 / £ ; Payment date : 3 months ; 3 months interest rate India : 12% p.a ; U.K. : 5% p.a. What should the exporter do? **(10 Marks)**

7 a. What is multilateral netting? **(03 Marks)**
b. What is economic exposure? Give the marketing and production initiatives of managing economic exposure. **(07 Marks)**
c. Elucidate the methods used to invest internationally. **(10 Marks)**

8 <u>CASE STUDY</u> :

Acer Ltd., has bought Swiss auto parts two months ago. Acer Ltd will need SFr 1,00,000 in 180 days. The company wants to hedge its currency risk. Acer Ltd., considers
a. Forward hedge b. Money market hedge c. Option hedge d. No. Hedge.
Its analysts develop the following information which can be used to assess the alternative solutions. Spot rate \$ 0.68 / SFr ; 180 day forward rate \$ 0.70 / SFr. Interest rates are as follows : Deposit rates : Switzerland – 9% ; US – 13% ; Borrowing rates : Switzerland - 10% ; US – 14%. A call option on SFr that expires in 180 days has an exercise price of 0.70\$ / SFr and a premium of \$ 0.02.
A put option on SFr that expires in 180 days has an exercise price of 0.7 \$/SFr and a premium of \$ 0.03.
The future spot rates in 180 days were forecasted as follows :

Possible Outcomes	Probability
\$ 0.67	0.30
\$ 0.70	0.50
\$ 0.75	0.20

Advise the company. **(20 Marks)**

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